A *review by the* **Federal Reserve Bank of Chicago**

# Business Conditions

**1956 April**

**Contents**

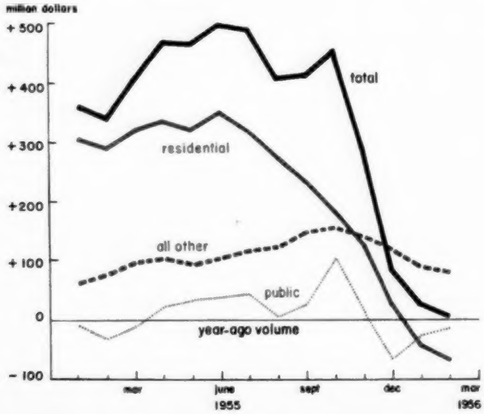

| | |
|---|---|
| Meeting the demand for mortgage credit | 4 |
| District dimensions: banking | 8 |
| Bank lending to farmers | 10 |
| Deposits reflect income trends | 12 |
| **The Trend of Business** | **2-4** |

# THE Trend OF BUSINESS

Late last fall most business measures ceased pushing upward and began to exhibit a remarkable stability which persisted through the early months of 1956. In fact, such important indicators as retail sales, manufacturers' sales and new orders, employment and construction all showed slight declines in February after allowance for seasonal factors. Nevertheless, optimism regarding prospects in the months ahead has strengthened in recent weeks.

A number of factors have played a part in bolstering business sentiment: (1) failure of the automotive cutback to spread to other lines, (2) extreme bullishness of recent surveys of consumer and business spending plans, (3) indications that Federal spending will rise somewhat in the coming fiscal year and (4) a renewed rise in stock prices. These developments have tended to reduce caution and caused business to forge ahead with expansion plans.

**Housing construction** below year-ago level, but other private building shows gains

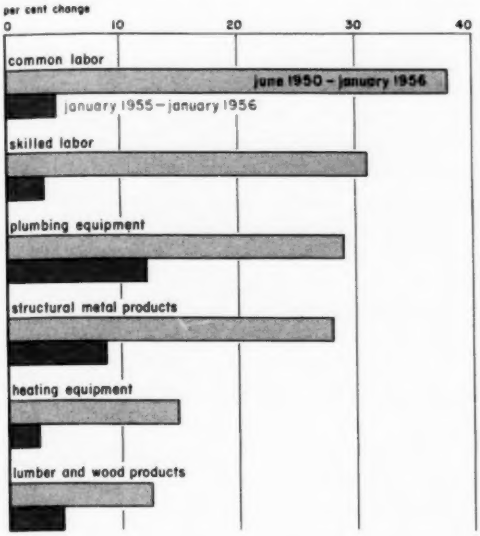



Consumer buying of autos and houses remains the big question mark for this year, with sales in both areas just now emerging from midwinter lows. Hopes that demand will continue strong this year have been strengthened by preliminary results of the 1956 *Survey of Consumer Finances.* Consumers are reported to be unusually optimistic regarding both their own income and job prospects and business conditions generally. Plans to purchase houses, cars and other durable goods, moreover, are as numerous as in early 1955 and higher than in 1954. This should not be taken as a forecast of sales in these areas, since early 1955 intentions fell far short of the excellent sales results during that year, but it does strongly suggest that no serious lagging of demand in consumer markets is in prospect.

### Construction activity to rise

In recent years, construction has accounted for one dollar in ten of the nation's total expenditure on goods and services. About the same proportion of the work force is employed in this field either directly or in the production of materials and services. The sheer magnitude of construction activity would account for current interest in this field, but it is also significant that these expenditures have risen by 1 to 6 billion dollars in every postwar year and helped to bolster the moderate recessions of 1949 and 1954. Government estimates made last fall pointed to a 5 per cent increase in 1956, to a total of 44 billion dollars. If this

## **Building costs** shoot up on strong demand




volume is to be achieved for the year as a whole, a sharp gain from present levels will be needed. Estimates of total construction put in place trended downward from last September through January. But contract award information published by F. W. Dodge and *Engineering News Record* indicates that a reversal of this decline is now in process.

Construction contracts, seasonally adjusted, began to show improvement in the final months of 1955, and in January and February they exceeded the same period of last year by 21 per cent. All major groups shared in the rise to some degree.

The construction picture is clarified if viewed in its three major segments—residential, government and "all other." Each accounts for about one-third of the total. Most forecasts call for some decline in *housing starts* this year despite recent moves to ease mortgage credit. In January and February, estimates of starts nationally were at a 1.2 million annual rate compared with a 1.4 million rate last year. For Chicago and Milwaukee, however, the number of housing permits issued showed a 20 per cent rise over a year ago, a decided contrast with the national picture. But for Detroit, where residential construction had been at a high level in postwar years and auto employment has been cut back recently, housing permits show a sharp decline.

*Public construction* is expected to rise by about 10 per cent in 1956. Biggest dollar gains are to be in schools and highways. Proportionately large increases are also planned for public housing, sewers and water works, and the many other installations necessary to provide services to new residential areas.

But the spotlight is on the *industrial and commercial* categories. Strong construction contract award trends in these fields, together with huge order backlogs for machinery and equipment, foreshadowed the SEC announcement of mid-March that total business capital outlays are expected to rise by one-fifth in 1956. For the first two months, contract awards for industrial, public utility and commercial building were about double the amount of the same period of 1955.

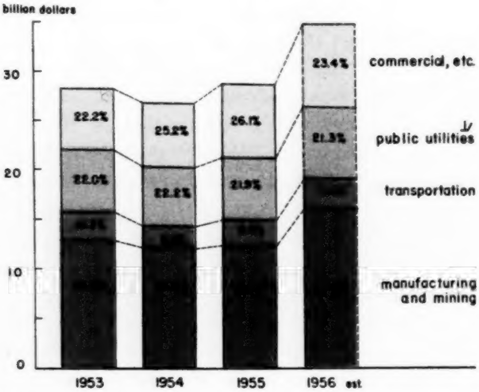
In the commercial field important new office buildings, shopping centers and warehouses have been announced in recent months. A number of sizable electric power and telephone expansions are under way and, among the manufacturing lines, steel, cement and a variety of metal-fabricating industries are contributing to the construction boom.

In March, U. S. Steel joined the parade of producers who have announced plans for steel expansion in the Chicago area. Expansion of

## **Steel expansions** under way in Chicago area

| | Present capacity | Proposed by 1959 | Per cent increase |
|---|---|---|---|
| | (in 1,000's of tons) | | |
| U. S. Steel | 12,645 | 14,145 | 11.9 |
| Inland Steel | 5,200 | 6,000 | 15.4 |
| Youngstown | 2,738 | 3,338 | 21.9 |
| Republic | 1,232 | 1,544 | 17.3 |
| International Harvester | 1,000 | 1,200 | 20.0 |

**Capital expenditure** surge led by manufacturing




[1] Includes communications.

facilities to begin this year at the Gary and South Works of "the Corporation" will add between 1.2 and 1.5 million ingot tons or about 10 per cent to capacity. On the same day Illinois Bell Telephone announced that the 115 million dollars spent on capital equipment last year will be exceeded by 1956 outlays of 136 million and a further rise to 150 million in 1957.

### Costs continue to mount

Shortages of structural steel, cement and glass continue to plague new construction projects. In fact, most building materials are on allocation from manufacturers. Steel work for large projects must be scheduled 12 to 18 months in advance. Glass requirements have been raised by extensive storm damage in the East. Cement requirements of the ever expanding road building program resulted in many building delays last year, and a similar situation is likely to prevail in 1956.

Pressure upon the supplies of men and materials in the building fields all along the line has brought substantial price increases during the past year. Since last spring lumber, steel, plumbing supplies, brick, glass and cement have all moved up by 5 to 10 per cent. Building tradesmen are receiving up to 15 cents per hour more than a year ago, and most union contracts call for an automatic 7 to 8 cent additional rise next June.

# Meeting the demand for mortgage credit

The residential building industry has long been regarded as one of the most important users of the nation's capital and resources. This has been especially true in recent years as housing standards have been on the upgrade and home building has boomed. Since the beginning of 1950, seven million privately-owned urban dwellings have been constructed at a cost of more than 75 billion dollars, excluding land. Last year alone private housing starts totaled more than 1.3 million units and residential construction expenditures, 16½ billion dollars.

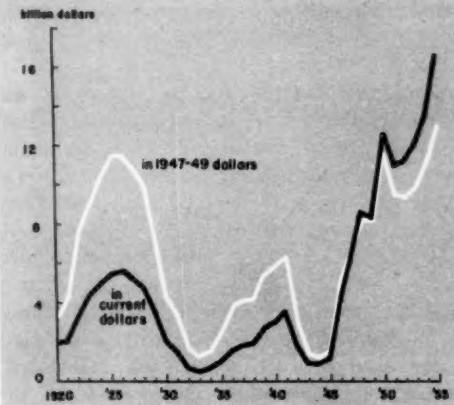
Reflecting the vigorous demand for new housing, residential building outlays in the postwar years have grown more rapidly than the total national output of goods and services. In 1939 and 1940, following the long period of depressed construction activity, home building accounted for slightly less than 3 per cent

of the gross national product. Last year residential building climbed to 4.3 per cent of the total national output—half again as much as before the War but substantially less than in the mid-1920's.

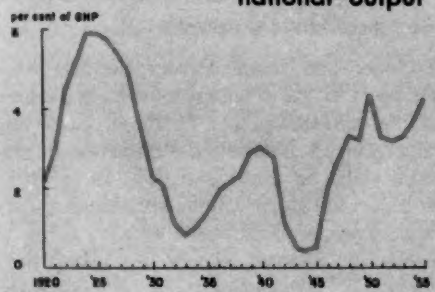
Builders thus have succeeded in attracting an increasing share of the nation's available labor and material—essentially scarce commodities which are in demand elsewhere in the economy. But the growth in building activity to its highest relative level in 25 years has not been without a price. Residential construction costs have increased more than 150 per cent since 1939, while over-all prices of goods and services have risen about 100 per cent.

In addition to labor and material, the home-building industry requires enormous amounts of credit—also in strong demand elsewhere in the economy. While most buyers put up some equity money and a few pay for their houses entirely with cash, the financing of residential property—both new and existing—typically involves the use of credit. With high levels of new building and large-scale transfers of existing property, often at higher prices, credit requirements of this sector of the economy have been growing rapidly. Mortgage debt on 1-4 family houses at the end of 1955 totaled 89 billion dollars, double the debt of only five years earlier. Moreover, the net growth in debt has accelerated, amounting to 7.5 billion dollars in 1953, 9.5 billion in 1954 and more than 13 billion in 1955. These increases, of course, have taken place in addition to the reinvestment of the growing volume of mortgage repayments and refinancings—estimated at 15 billion dollars last year.

**Residential construction** was at new record last year, in dollars and physical volume . . .




but still trails well behind the mid-1920's in relation to total national output




### Home building and saving

Construction, like other durable goods industries, plays an especially significant role in our economy because it adds to the nation's stock of real capital resources. And investment in capital assets by business, individuals and governments is very closely related to saving.

Although the processes of saving and of investment are often independent acts made by different groups or individuals, it is obvious that saving—that is, not consuming all of one's current income—is necessary in order to permit someone else to invest in excess of current resources. Thus, saving and investment for the nation as a whole are, in effect, two sides of the same coin.

In some cases, decisions to save and invest are made by the same person, as when an individual invests in his own house or a cor-

poration invests retained earnings and depreciation allowances in new plant and equipment. But, to a substantial extent, saving and investment are separate processes, involving the accumulation of funds by savers which are transferred, either directly or through institutions, to others who wish to borrow and invest these funds.

Residential building has accounted for an increasing share of the nation's private capital formation in the postwar years. By the same token, a growing proportion of the nation's saving has been used by the building industry and its customers. Gross capital formation—financed through private saving plus or minus governmental surpluses or deficits on current account—has run between 48 and 60 billion dollars annually in recent years. In relation to the total of such investment, residential construction expenditures increased from 13 per cent in 1946 to 26 per cent in 1950. This proportion dropped abruptly to 20 per cent in 1951 but since then has increased to postwar peaks of 28 per cent in 1954 and 1955.

### Competition for credit

Builders and home buyers compete with other users of the economy's financial savings. And the competition can be tough. State and local authorities hold out the attraction of tax-exempt yields to those who want to invest in their securities. Corporations are able to satisfy a large share of their needs without going to the market directly, simply by using their depreciation allowances and undistributed profits. The Treasury, still one of the biggest users of borrowed funds, has special advantages arising out of the quality of its debt and its ability to tailor its credit instruments to the specific needs of lenders.

Yet, the home-building industry cannot be cast in the role of a stepchild. The tax laws have given substantial encouragement to home ownership by making the imputed income from owning rather than renting tax free and by allowing the deduction from gross income of real estate taxes and interest payments on mortgage loans. Moreover, the part played by the VA and FHA in establishing a preferred status for residential mortgage paper can hardly be exaggerated.

Given the present framework of competitive advantages and disadvantages, the amount of funds moving into mortgage credit depends on two factors: first, the volume of financial saving, including reinvestment of funds received from loan repayments, and second, the scale of the demands made on the available supply of funds by other prospective borrowers. Both of these factors, in turn, are directly influenced by the course of business activity and the monetary action which accompanies it.

The Flow-of-Funds study, recently published by the Federal Reserve Board, provides a convenient source for estimates of the amounts of funds provided credit-users through the money and capital markets. Eliminating double-counting resulting from the flow of funds through intermediaries, such as banks and other financial institutions, the volume of credit supplied from financial sources from 1950 through 1954 ranged between 30 and 40 billion dollars annually, net of debt repayments. In 1955, financial flows appear to have been

**Home mortgage** debt expansion has been a large user of the total available supply of credit


*Excludes currency and institutional deposits to avoid double-counting.

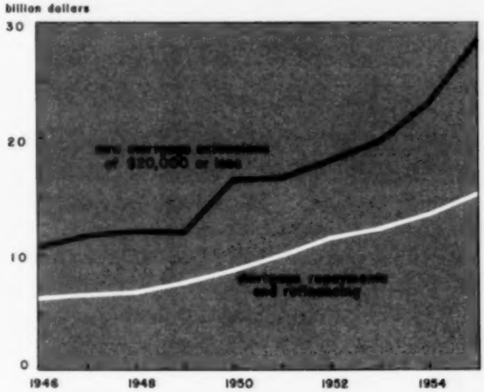
especially large—perhaps in excess of 40 billion dollars—partly owing to a large expansion in corporate trade receivables which accompanied the upsurge in business activity.

Not all of these funds, of course, were open to investment in mortgages. Some lenders, by their very nature, have strong preferences for short-term securities or for tax-exempt obligations. Other lenders, such as manufacturing, wholesale and trade firms, advance credit for the most part only as an incidental part of carrying on their regular operations; this is the case with most trade credit. But a substantial portion of the new funds entering the credit markets may be used in any of the various intermediate- or long-term investment outlets, depending on current circumstances and the relative attractiveness of the competing investments. Moreover, over time, investments may be shifted from one outlet to another, through the medium of reinvesting repayments on outstanding obligations.

Corporate security issues, loans to businesses and farmers, municipal bonds, consumer instalment credit and the Federal debt, then, are all competitors with the mortgage market, at least insofar as marginal shifts of funds are concerned. Despite this variety of outlets, more than one-fifth of the total expansion in financial assets from 1950 through 1954 represented flows of funds into mortgages on 1-4 family properties. In 1954 alone, the proportion was 30 per cent, and last year it appears to have been even higher, despite the sharp expansion in short-term forms of saving and indebtedness.

The effectiveness of mortgages in competing for long-term savings through those channels accustomed to mortgage investment is even more striking. Of the total increase in the assets of life insurance companies, savings and loan associations, mutual savings banks and time deposits in commercial banks from 1950 through 1954, 70 per cent flowed into mortgage debt of all kinds. Under the pressure of intense demands, particularly on residential properties, this proportion rose to more than 80 per cent in 1955. Last year, mortgage holdings of commercial banks rose considerably

**Mortgage repayments** have risen, but new credit extensions on small properties have increased even faster




more sharply than their time deposits for the first time since 1950.

## Moderating monetary policy

A consumer of credit in the magnitude of the mortgage market is profoundly and inevitably affected by national credit developments, which in turn are influenced by the course of national monetary policy. Federal Reserve policy is, and must be, attuned primarily to the over-all national economic situation. If, in years like 1955, rapid expansion in credit is feeding an aggregate demand for goods and services which threatens to outrun the available supply, a more restrictive monetary policy clearly is called for. To follow any other course is to invite unrestrained upward price pressures which could have serious inflationary consequences to the detriment of the general welfare.

Although shifts in monetary policy have their greatest initial impact on the availability of bank credit and short-term money markets, these effects tend to spread to longer-term markets and all types of credit users and instruments. The speed with which this takes place

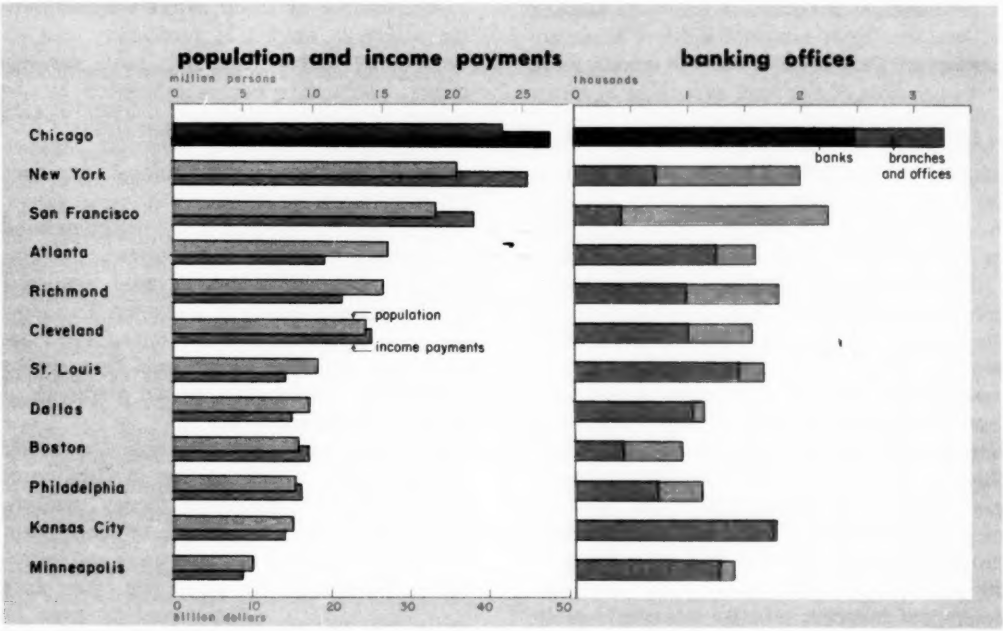
*—continued on page 15*

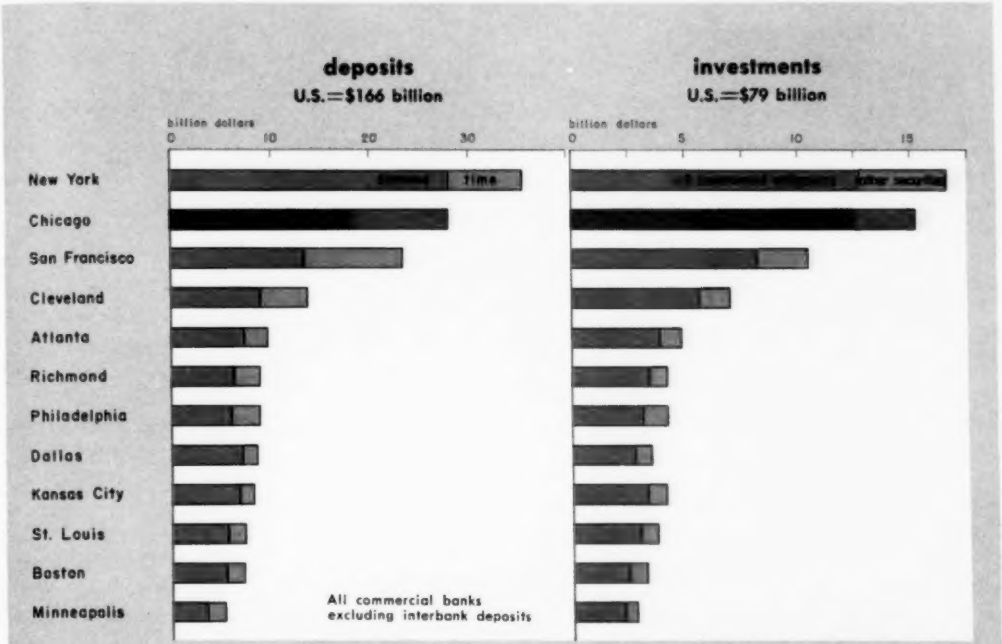
# DISTRICT DIMENSIONS: banking

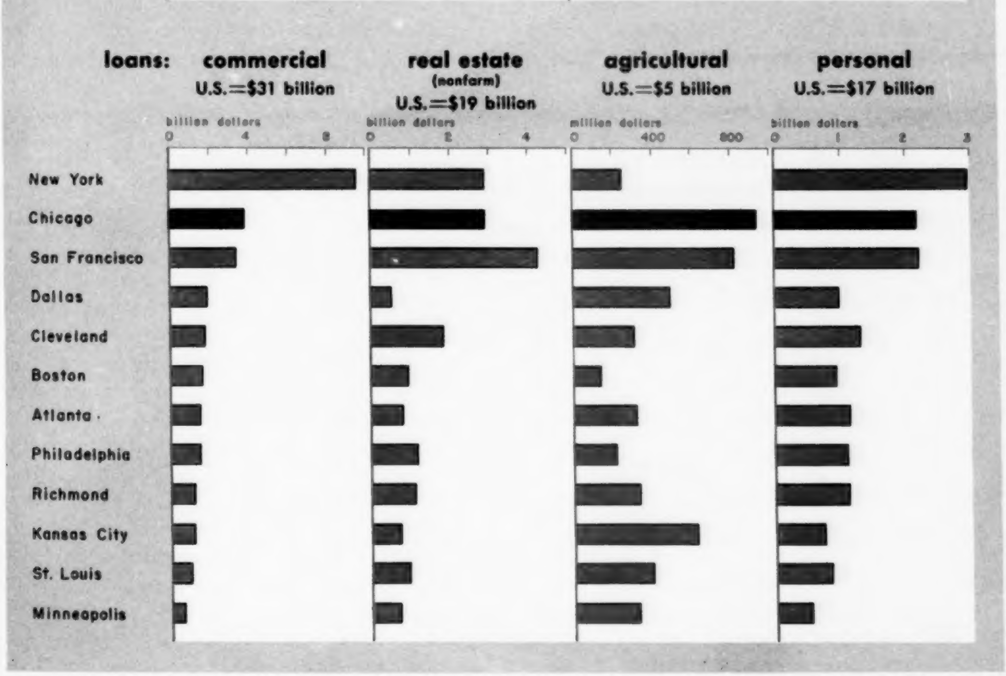

This is the first in a series of brief resumes describing the place of the Seventh Federal Reserve District in the nation's business and financial structure. Succeeding issues of *Business Conditions* will place other segments of Midwest business in similar perspective.

Geopolitically speaking, the Seventh Federal Reserve District is a slice of America's "heartland." Its boundaries encompass about one-sixteenth of the nation's area, more than one-sixth of its population and almost one-fifth of total U.S. income payments.

Ministering to the Seventh District's individuals and businesses are nearly 2,500 commercial banks—more than in any other District. The reasons for this large number of banks can be found in the size of the District, the provisions of its state banking legislation, the diversity and vigor of its businesses and the relatively high income level of its people. Many of these same reasons have molded other characteristics of Seventh District banking as well, some of which are presented on the next page in comparison with the eleven other Federal Reserve Districts.




deposits
U.S.=$166 billion
investments
U.S.=$79 billion
billion dollars
0
10
20
30
time
billion dollars
0
5
10
15
New York
Chicago
San Francisco
Cleveland
Atlanta
Richmond
Philadelphia
Dallas
Kansas City
St. Louis
Boston
Minneapolis
All commercial banks
excluding interbank deposits


loans:
commercial
U.S.=$31 billion
real estate
(nonfarm)
U.S.=$19 billion
agricultural
U.S.=$5 billion
personal
U.S.=$17 billion
billion dollars
0
4
8
billion dollars
0
2
4
million dollars
0
400
800
billion dollars
0
1
2
3
New York
Chicago
San Francisco
Dallas
Cleveland
Boston
Atlanta
Philadelphia
Richmond
Kansas City
St. Louis
Minneapolis

# Bank lending to farmers

For each dollar of loans outstanding at banks in the Seventh District, about ten cents represents loans to farmers. But for nearly three-fifths of the 2,500 banks in the District, agricultural loans make up one-third or more of their total loan portfolio.

To these agriculturally oriented banks, changes in the farm economy can and do have a significant impact. Currently, many rural banks find their loan totals crowding record levels while deposits have declined (see article beginning on page 12). These trends are centered in the Corn Belt where cash receipts from farm marketings in 1955 trailed year-earlier levels by about 10 per cent, due largely to lower prices for hogs and cattle, although in some areas drouth reduced crop output and augmented the income decline.

Farm loans (excluding those guaranteed by the Commodity Credit Corporation) held by member banks at the beginning of the year were at a record post-World War II level. "Production" loans at District member banks exceeded year-earlier levels by 14 per cent while loans secured by farm real estate showed a gain of nearly 9 per cent. Contributing to the sharp increase in agricultural loans is the decline in farmers' cash balances from the high levels in recent years as gross receipts have tapered off and production costs have continued high. Also the volume of loan renewals has risen. The large requirements for operating capital and the continued investment in labor-saving equipment and buildings are important underlying factors that are expected to keep the trend in farm debt tilted upward.

However, in individual type-of-farming areas, credit conditions diverge considerably from the over-all pattern, especially over short periods of time. Credit requirements of farmers in a dairy area differ materially from those in a cash grain or a livestock-feeding area both as to amount, type and seasonal needs. Moreover, they fluctuate from one year to another in response to variations in output and prices of products in which the areas specialize.

### Banks provide new information

Heretofore, relatively little information has existed on the changing characteristics of farm credit and the flow of credit to farmers in different type-of-farming areas. To help fill this void in the credit statistics, a reporting program has been initiated recently in cooperation with about 100 Seventh District banks. The cooperating banks provide detailed information on the amount, term and purpose of new farm loans and on the characteristics of farmer borrowers. Similar information is reported on renewed loans. The data are tabulated at the Reserve Bank for each of five agricultural areas. First results from this program are available for a group of banks in the cattle and hog areas of Iowa and Illinois. From this group some important economic characteristics of the flow of credit to Corn Belt livestock farmers are being brought into sharper focus.

### Winter credit use

In Corn Belt livestock areas, over two-fifths of the credit extended to farmers in early 1956 was for the purchase of feeder cattle. Thus, even during January and February when such purchases usually make up only 10 per cent of the year's total, cattle loans dominate the credit picture in these areas.

By far the largest number of loans were for general operating expenses. However, these loans averaged only about $1,000 in size. As a result, the total amount of credit extended to buy feed, seed, fertilizer, petroleum products and the like ran a poor second to purchases of feeder cattle. Slightly less than a fifth of the credit granted was for general operating expenses.

The remaining two-fifths of the farm loans made during the early part of the year were distributed between purchases of machinery, livestock other than feeder cattle, personal expenses, debt consolidation and the improvement and purchase of land and buildings.

### Renewals—an important part

Many farm loans are made with the understanding that they can be renewed if conditions warrant such action at the time the loan matures. As a result the renewal of loans is a regular feature of the lending at many banks. All told, slightly over one-third of the farm loans made during midwinter represented an extension or renewal of old loans.

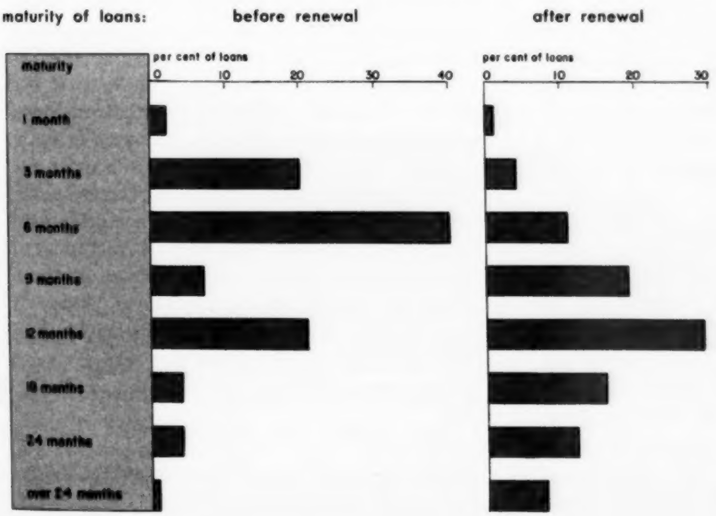
Loans made to finance farm improvement programs or purchase the more expensive pieces of machinery might properly be amortized over a number of years. However, a considerable portion of the credit for these purposes is written for terms of six months to a year but with the option of renewal. Reports of cooperating banks indicate that over half of the credit extended for machinery and four-fifths of that extended for the purpose of improving land and buildings appeared in the form of loan renewals or extensions in the early part of the year.

The largest portion of renewals, almost half of the total dollar amount, was of loans made for general operating expenses. This segment of the renewal volume largely represents loans that normally would be paid at the end of the production period or usual marketing date for the commodity. They were carried over because lower prices or crop failure reduced income below the expected amount or some unusual expenditure forced a diversion of income to other uses.

Another important category of renewed loans was for feeder cattle. While almost one-fifth of the total amount of renewals were feeder cattle loans only a tenth of the total credit extended for feeder cattle represented renewed loans. The relatively small portion of feeder cattle loans being renewed indicates that, despite substantially lower returns from cattle feeding, most of these loans are liquidating in a satisfactory manner. Moreover, most of these renewals were for short periods of time and apparently represented a delay in sale of the fattened cattle.

In the months ahead, seasonal credit requirements and variations in weather, prices and income may alter these patterns of credit use substantially. For example, as the seasonal peak approaches for machinery sales, new loans will no doubt assume a more important place in the credit extended for this purpose

**Most farm loans** are written for six months or less; renewal often lengthens effective term to 12 months or more



while renewals will decline in relative importance. Likewise, a higher portion of the general operating expense loans will probably be represented by the extension of new credit. Under the impact of these seasonal demands for credit, it remains to be seen whether credit extended for feeder cattle will continue to dominate the loan totals in the livestock-fattening areas of the Corn Belt.

As the flow of data continues and information is obtained from other parts of the District, the pattern of credit use will unfold more clearly and information will become available for other type-of-farming areas. This should prove a valuable aid in sizing up the financial requirements of farmers and provide the banking system with information which will help it to evaluate agriculture's credit needs and to accommodate them wisely. Other characteristics of agricultural loans at commercial banks will be described in succeeding issues of *Business Conditions.*

# Deposits reflect income trends

Individuals and businesses had almost 5 per cent more money on deposit in Seventh District member banks on December 31, 1955, than a year earlier. This deposit growth was slightly less than that for all member banks in the nation. It represents a gain of almost a billion dollars, three-fourths of which was in demand and one-fourth in time deposits.

The over-all totals, however, hide sharp differences between geographic areas within the District and also between rural and urban banks within some of those areas. At one extreme is the highly industrialized economy of eastern Michigan. At the other is predominantly rural Iowa. In most regions, of course, there is a mixture of industry and agriculture in varying proportions.

While 1955 was generally a year of rapidly rising income, there was considerable variation in the rate of growth among different segments of the economy. For the most part, those industries which suffered the worst slump in the 1953-54 recession made the greatest gains last year. As a result, deposits in some industrial areas spurted upward by 10 per cent or more.

But as industry prospered, agriculture continued to decline. Although farm production increased in most areas, lower prices resulted in a decline in farm income. Income movements, of course, were not the same for all types of farming. Receipts from sales of livestock fell more than receipts from crops, while dairy income actually improved from the previous year. The decline in receipts from farm marketings was about 10 per cent for Illinois, Indiana and Iowa but only 3 per cent for Michigan and Wisconsin. Deposit drains were largely concentrated in livestock-feeding areas. Outside these regions, even rural banks showed some deposit growth, either because other types of farm income held up well or because the effect on deposits of falling farm income was more than offset by the rise in nonfarm activity.

In general, the larger the town the more the fall in farmer deposits was cushioned by rising nonfarmer accounts. Banks in medium-sized District centers—between 10 and 50 thousand population—tended to gain more than did those in smaller communities. Moreover, most of the growth in places under 10 thousand was in time deposits, which move less closely with income trends than do checking accounts.

### Five states compared

Although types of economic activity do not correspond precisely with state boundaries,

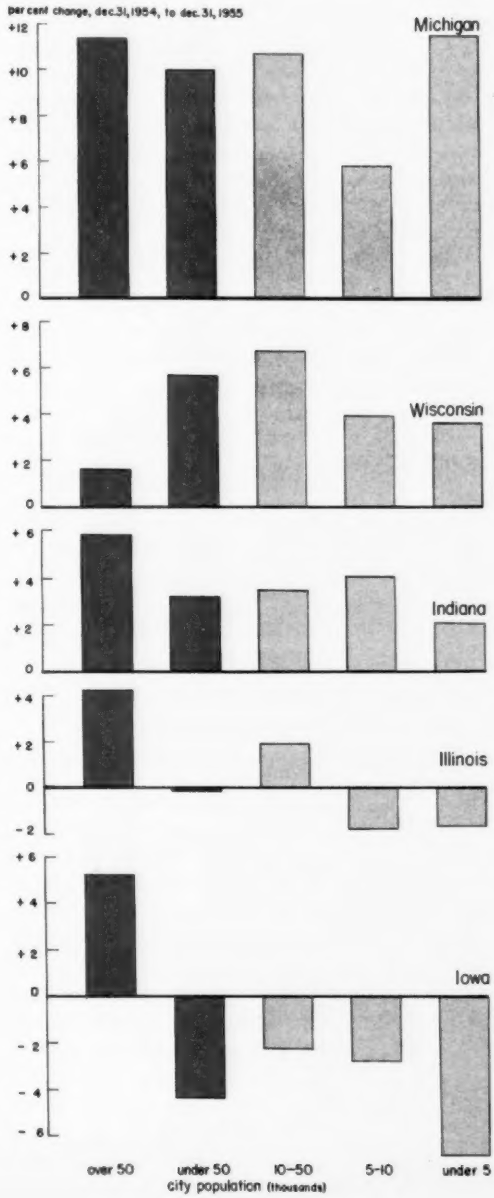
each of the five District states has certain dominant characteristics which account for differences in income patterns.

"As goes the automobile industry, so goes Michigan." Accompanying peak rates of automobile output in 1955, the deposit expansion in that state far exceeded gains in any other part of the District. Here, member banks, which at the beginning of the year held about one-fourth of the five-state deposit total, accounted for almost half of the District's deposit growth. Demand deposit balances of individuals, partnerships and corporations grew 11 per cent and time deposits roughly half as fast. Unlike most other Midwest areas, city and country banks shared in these gains about equally. Even in the small communities of Michigan, farm activity is overshadowed by other types of employment. Furthermore, many farmers supplement their incomes by working in the small auto parts plants which support so many of Michigan's smaller towns.

South and west across the Indiana border, other lines of industry—particularly railroad equipment and electrical and other machinery—assume greater importance. Here there was less spectacular, but nevertheless substantial, expansion in 1955. Deposit growth was greater for Indiana's large city banks than for their rural colleagues, but even the latter averaged increases of over 3 per cent in both demand and time accounts. That these rural banks in the Corn Belt area made so good a showing is probably attributable to two factors—the still large ratio of nonfarm income to total and the relatively large volume of 1955 crop output which helped to maintain farm income by offsetting declines in agricultural prices.

In Wisconsin the pattern was somewhat different. Except for Kenosha, there was little expansion in either time or demand deposits in Wisconsin's major cities. On the other hand, most of the agricultural area banks in dairy regions showed substantial increases in checking account balances. Dairy farming was one of the few segments of agriculture which showed improvement last year and, as a result, cash receipts of all Wisconsin farm marketings

## **Demand deposit gain** in 1955 by-passed smaller cities of Iowa and Illinois



dropped less than did those in rural areas which specialize in livestock and grains.

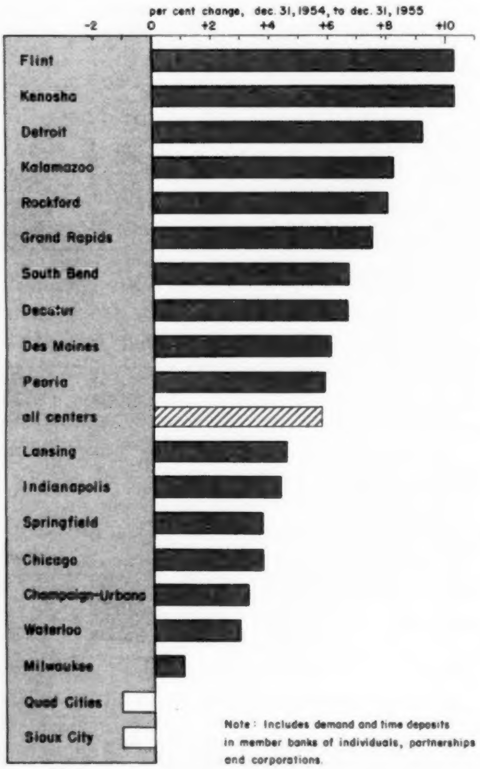
A seeming anomaly in the Wisconsin picture is the consistent decline in time deposits throughout the state. Outside metropolitan areas, roughly half of member bank deposits are in time accounts. The failure of these accounts to grow commensurately with checking accounts may indicate that a greater proportion of deposit balances accrued to small businesses rather than to individuals. It may also mean that aggressive efforts by competing savings institutions have cut into member banks' share of these deposits.

The pinch of falling farm income is most noticeable in the rural areas of Illinois and Iowa. Outside large cities, three out of five banks in Illinois and four out of five banks in Iowa reported declines in demand deposits last year. Except in metropolitan areas of these states, manufacturing and other business pursuits are minor sources of income. The greatest impact of declining farm income fell on banks in the smallest communities, particularly in those areas of Iowa where hogs provide the major source of income.

With the exception of the Quad City and Sioux City areas, the large urban centers showed impressive gains in demand deposits. Moreover, expansion in time deposits, though not large, was fairly general over Illinois and Iowa. Time deposits in these two states are largely nonfarmer accounts.

Iowa is the only District state where the aggregate deposits of banks in small centers exceed those in large cities. Here the drains on checking accounts which accompanied shrinking farm income were more than sufficient to offset the growth in time deposits and the higher balances carried in business centers. In Illinois, on the other hand, the overwhelming dominance of deposits in large cities resulted in a net increase of more than 3 per cent in the total of both demand and time accounts at all member banks in the state.

**Total deposits** rose in most of the District's metropolitan areas

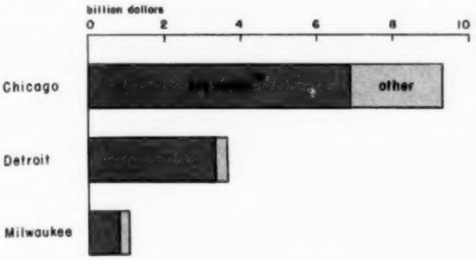



## City growth varies

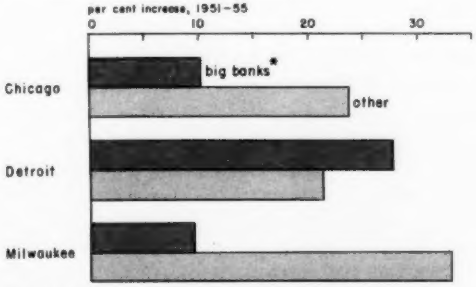
Industrial expansion in 1955 naturally had its greatest impact on deposits in Midwest cities. Member banks in the 32 metropolitan areas of the District showed a net gain of 6 per cent in demand and 3 per cent in time deposits. Comparison of relative growth among individual cities shows the unmistakable influence of the automobile industry's "best year in history." Flint, Kenosha, Detroit and South Bend were among the leaders. In Kenosha, of course, the expansion was partly due to the fact that American Motors moved facilities into that city from other areas.

Within the District's largest cities there has been a tendency in recent years, apart from cyclical influences, for smaller banks in out-

**Big city banks** held the preponderant portion of total deposits at the end of 1955 . . .




but only in Detroit is their share increasing




*Big banks are central reserve city banks for Chicago and reserve city banks for Detroit and Milwaukee.

lying areas to grow much faster than the bigger, centrally located institutions. Since 1951 Chicago central reserve city banks and Milwaukee reserve city banks have gained deposits less than half as rapidly as did other member banks in these two cities. In Detroit, however, reserve city banks have nearly kept pace with outlying banks, and last year the rise in deposit accounts at these big banks was almost 15 per cent—so dwarfing changes for others in the Detroit area that it more than made up for ground lost in earlier years. Part of the deposit expansion at the big Detroit banks last year undoubtedly reflected the sharp upsurge in the automobile industry. Some of it was due to the absorption of deposits of banks in outlying areas through consolidation.

Probably the most important factor contributing to the more favorable experience of the central city banks in Detroit, however, is their ability to establish branches. Branch offices make it easier for the large "downtown" banks to acquire their proportionate share of growing personal accounts as the populations of metropolitan areas become more and more decentralized.

## Import for bankers

The significance of relative changes in deposits depends somewhat, of course, on the levels at which the year began and on the trends in the previous period. To the extent that gains made during 1955 were due to the cyclical upswing in business, many banks were making up for the sluggish behavior of deposits during 1953 and 1954. For most city banks, however, the recession marked no more than an interlude in a rising trend.

But predominantly rural banks have felt, in addition to 1955 deposit changes, the cumulative effects of falling farm prices over the past four years. With little prospect that farm income will rise in the foreseeable future, rural bankers in some areas are becoming concerned lest recent deposit drains denote a trend.

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## Mortgages—*continued from page 7*

and the extent to which ease or tightness is transmitted to other credit markets, however, vary substantially with conditions at the time.

The timing and severity of the impact of a tighter credit policy on mortgage markets is especially hard to forecast, since mortgages are far removed from the short-term market and have unique institutional properties. The widespread use of pre-commitments in financing new project building, the importance of savings and loan associations—a specialized mortgage lender in many local markets—and the convention of fixed interest rates on the face value of FHA and VA loans, for example, may have important repercussions on the extent to which

mortgage markets are influenced by a change in credit policy of any given dimension.

### Influencing the mortgage market

The mechanism by which changes in monetary policy are transmitted to mortgage market conditions nevertheless is clear. In the first place, a more restrictive policy will influence the willingness of banks to supply funds directly to the mortgage market both through long-term mortgage lending and the extension of short-term warehousing and accommodation loans to mortgage companies, their principals and builders. When commercial banks have become important marginal suppliers of short- and long-term mortgage credit, as was the case last year, a tighter reserve position can have considerable impact.

Second, higher interest rates for short-term credits will tend to spread to the longer-term credit instruments as lender preferences shift in response to the changing rate structure. This tendency will quickly be reinforced by the change in market attitudes regarding future prices and yields which accompanies the move toward a more restrictive monetary policy. The impact of such higher yields in the mortgage market, in turn, will depend upon the willingness and ability of builders to absorb larger discounts on FHA and VA paper and the attitude of home buyers regarding higher conventional loan rates.

Finally, it must be remembered that the funds flowing into mortgages are part of a larger credit pool. If the expansion of that pool is circumscribed in one area, all other areas will be affected. Some short-term borrowers—for example, sales finance companies—may turn to long-term sources for a larger share of their needed funds. And some long-term lenders may divert a larger portion of their funds into short-term securities to take advantage of the relatively higher yields. Thus, even if monetary policy did not directly affect the supply of mortgage credit, mortgage markets would still be influenced by credit policy.

In the past year, mortgage markets have tightened appreciably. In part, this was a result of a more restrictive credit policy. Bank reserves were not actually reduced during the year, but with the demand for credit exceeding the available supply, pressure was maintained almost continuously on reserve positions. In addition to the tighter credit situation generally, mortgage markets reflected a serious imbalance of demand and supply internally. The much larger expansion in such debt last year, combined with the accumulation of a large backlog of lender commitments in the first half of the year, resulted in an especially severe tightening in the availability of funds later in the year.

### The year ahead

There is evidence that the mortgage market is now in the process of easing. Backlogs of commitments have been worked down by most lenders and the net expansion in mortgage debt should be smaller than during 1955, reflecting the steadily growing repayment volume and a somewhat lower level of new building. Moreover, the inflow of savings to financial institutions ought to expand along with the higher level of personal incomes and a somewhat less intense demand for consumer durable goods. Such a trend, however, implies no specific forecast regarding the course of over-all monetary policy. Some easing in a particular credit market is perfectly consistent with an over-all situation which is little changed. National credit policy will continue to be attuned primarily to general economic conditions, establishing a climate in which each credit-using industry flourishes in step with its ability to attract resources, credit and customers.

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